United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

(Proof of service attached)

74-2550

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P/S

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

BROWNING DEBENTURE HOLDERS' COMMITTEE, et al.,

Appellants,

-against-

DASA CORPORATION and ARTHUR ANDERSEN & CO.,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR

THE SOUTHERN DISTRICT OF [illegible]

REPLY BRIEF OF APPELLANTS

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POINT I

IN RESPONSE TO PLAINTIFFS' CONTENTION THAT DASA'S 1972 PROXY MATERIALS UNLAWFULLY FAILED TO DISCLOSE A CONFLICT OF INTEREST BETWEEN ITS DUTIES TO THE STOCKHOLDERS AND ITS DUTIES TO THE BONDHOLDERS ON THE QUESTION OF THE NEW CONVERSION PRICE, DASA MAINTAINS THAT NO SUCH CONFLICT EXISTED BECAUSE IT OWED ABSOLUTELY NO FIDUCIARY DUTY OF FAIRNESS TO THE BONDHOLDERS. BY TAKING THAT LEGAL POSITION IN CONNECTION WITH THIS APPEAL, DASA HAS RAISED AND PRESENTED FOR DETERMINATION BY THIS COURT A CRUCIAL AND BASICALLY DISPOSITIVE QUESTION OF LAW WHICH WILL FUNDAMENTALLY RESOLVE NOT ONLY THE ISSUE OF LIABILITY AS TO CLAIMS 1 AND 2, BUT ALSO THE ISSUE OF LIABILITY ON CLAIM 3.

One of the main defects of disclosure in Dasa's 1972 shareholder proxy materials alleged by the plaintiff in Claim 1 is the failure of Dasa to disclose the existence and potential consequences of a conflict of interest on the part of Dasa's management in connection with its deciding upon and offering to the debenture holders a proposed new conversion price in consideration of or exchange for consents necessary to accomplish the proposed sale of computers. In essence, plaintiffs' maintain that such a conflict of interest clearly existed, that the stockholders were entitled under Section 14(a) to be told the complete truth about it (including all significant facts about it), that Dasa failed to make the complete disclosure required by law, and that liability therefore exists under the statute.

The plaintiff bondholders also allege, in Claim 3, that the same conflict of interest and its consequences were inadequately disclosed in the solicitation letters sent to the debenture holders, that fiduciary duties owed by Dasa to them (under the Trust Indenture Act and state law equity principles) required that a fair, reasonable and equitable conversion price offer be made to them, that no such offer was made (or even attempted), and that Dasa is consequently liable to them on any one of those three theories of recovery.

In Point II of its brief (pp. 26-28), Dasa takes the position that there was no failure on its part to make reasonable disclosure of the alleged conflict of interest situation because there was no conflict of interests or duties on its part. The reason why no such conflict is said to have existed is that, as a matter of law, Dasa owed absolutely no fiduciary duty of fairness whatsoever to the holders of its convertible debentures in connection with the offer of a new conversion price to them in exchange for their collective consent to the proposed sale. And the reason why, according to Dasa, no such fiduciary duty of fairness existed is that the convertible bond holders were purely and simply creditors of the corporation, not stockholders, and the Dasa board of directors owed fiduciary duties in the circumstances only to the stockholders who elected them.

Of course that position was taken and made clear by Dasa's management to the plaintiffs at the directors' organization

meeting which followed the 1972 annual meeting in February of 1972 and preceded both the solicitation of the debenture holders and the subsequent sale of the computers on May 15, 1972. It was precisely because of that position and the logical consequences of it (a) that Dasa's management made no effort at all to offer a fair and reasonable conversion price (and did not do so), (b) that management rejected plaintiffs' suggestion that the fairness of the proposed conversion price be submitted to an independent, expert financial analyst, and (c) that the plaintiff bondholders felt compelled to bring this suit to rectify the consequent injustice to the bondholders (and did so).

With the market price of Dasa's common stock over-the-counter between $4 and $5 and falling steadily, it takes no financial genius to perceive that a new conversion price of $21 offered absolutely nothing of significance or present value to the bondholders. It was a completely empty and worthless gesture with not even a hint of fairness or equity to the bondholders about it. In order for the new conversion price to represent anything of any value at all to the bondholders, it would have had to bear some reasonable relationship to the current market value of the common and represent a figure that the common stock price might reasonably be expected to reach some time in the conceivable future. In 1972, there was absolutely no hope or prospect whatever that the Dasa common would ever again reach a price of $21. Dasa's management knew

that perfectly well, and subsequent events have proved that to be the case. The price of the common now, three years later, is around 50 cents; and Dasa has a negative shareholders' equity of approximately $30 million (as compared to annual gross revenues of around $10 million and annual operating income of $.42 million).

There is really no logical or rational need in this case for a trial and lengthy testimony from expert witnesses from the financial world to prove the obvious fact that no attempt was made by Dasa to offer the bondholders a fair and equitable new conversion price or that no such fair price was in fact offered. The facts speak for themselves, and they speak eloquently.

But even if a trial is necessary to establish what price range a fair and reasonable conversion price offer would have fallen within, no trial record is required for this court to decide on this appeal the pure question of law upon which the main pillar of Dasa's defense against liability on Claim 1 and Claim 3 rests: Did Dasa, or did it not, owe a fiduciary duty to its debenture holders pursuant to which it was obligated, under the Trust Indenture Act and general principles of equity, to offer a fair and reasonable new conversion price in connection with its solicitation of consents?

The question is clear cut. It is purely a question of law. All of the material facts are admitted and before the court. The arguments of the briefs present the issue in crystal clear form for determination by this Court.

Since that issue is unquestionably the linchpin of this entire action, only peripheral and consequential issues will remain for resolution at trial once it has been decided by this Court whichever way the decision may go.

The issue is one of first impression to be decided under principles of equity, whether incorporated into federal law through the Trust Indenture Act and other federal securities laws (e.g., Bailey v. Meister-Brau, Inc., _____F.Supp._____ (N.D. Ill., 6/5/74 & 9/27/74, McLaren, J.), CCH Fed.Sec.L.Rep., Curr. Vol., ¶ 94, 837; Lewis v. Dansker, _____F.Supp._____ (S.D.N.Y., 11/11/74, Knapp, J.), CCH Fed.Sec.L.Rep., Curr. Vol., ¶94, 862) or under state law equity principles (e.g., Seeburg-Commonwealth United Litigation, _____F.Supp._____ (S.D.N.Y., 1/24/75, McFadden, J.), CCH Fed.Sec.L.Rep., Curr. Vol., ¶94,969; Meinhard v. Salmon, 249 N.Y. Rep. 458 (1928); 89 C.J.S. Trusts §§139-159).

Dasa maintains, all too simplistically, that it is a simple matter of distinguishing stockholders (as "owners" of the corporation) from the holders of its convertible bonds (as "creditors" pure and simple, to whom no obligation of any kind is owed absent a default on the underlying debt). Plaintiffs maintain that the issue involves nothing more complex than the application of well-established principles of equity to a nexus of intra-corporate financial relationships no more complex in essence than the problem of the existence of fiduciary obligations owed by majority stockholders to minority holders in

so-called "sale of control" situations. 38 ALR 3d 1102; 40 Cornel L.Q. 786; 70 Colo. L. Rev. 1079; 11 N.Y. Jurisprudence, Corporations §§ 332, 336.

Just as the owner of controlling shares, owes, in general, no fiduciary duty to the minority holders, but incurs a fiduciary duty to them if he voluntarily undertakes to obtain in secret a bonus for the sale of his shares unknown and unavailable to the minority, so in the present situation Dasa probably did not owe any general fiduciary duty of responsible and fair dealing to the bondholders, but such a duty arose when Dasa undertook, for its own corporate reasons, to solicit the proxy consents of the debenture holders and to offer, in exchange for them, a proposed new conversion price. Dasa had taken $6 million from the debenture holders and used that money in its corporate business. Now it wanted to undertake a transaction which, if completed, would leave the corporation with over 22% less physical assets than it had before and which the debenture holders had it in their collective power to prevent. In that context of intra-corporate dealing between management and the unorganized and unrepresented bond holders, a fiduciary duty of honesty and fair dealing and due care to protect the interests of the bondholders and disclose all material facts to them was obviously created. No court of equity could in good conscience find otherwise. And that duty of care was, with even greater clarity and obviousness, violated by Dasa in this case. Indeed, its management virtually concedes that such a duty was violated if it existed. Dasa's only argument is that such a

duty did not exist.

In that, it was patently wrong. And this Court should so decide on this appeal.

For secondary authorities relevant to this action, see the following: M. A. Eisenberg, "Access to Corporate Proxy Machinery," 83 Harv. L. Rev. (May, 1970) 1489-1526; A. A. Sommer, Jr., "The Annual Report: A Prime Disclosure Document," 1972 Duke L. Rev. (Febr. 1973) 1093-1123; "Private Remedies Available Under Section 14(a) of the Securities Exchange Act of 1934," 55 Iowa L. Rev. (Febr. 1970) 657-673; P. B. Wright, "Convertible Bonds and Common Stock: A Theory of Equivalency," 36 Brooklyn L. Rev. (Spring 1970) 388-429; R. A. Malstrom, "Stockholder's Derivative Actions by Holders of Convertible Debentures," 6 Univ. of Michigan Jour. of Law Reform (Spring 1973) 760-780.

For a recent decision regarding the fiduciary duties of trustees under Section 315(d) of the Trust Indenture Act, see: Morris v. Kantor, _____F. Supp._____ (S.D.N.Y., 3/4/75, Ward, J.), CCH Fed.Sec.L.Rep., Curr. Vol., ¶94,996.

POINT II

THE MOST NOTABLE THING ABOUT DASA'S BRIEF IS ITS COMPLETE FAILURE TO RESPOND TO MOST OF THE MAIN ARGUMENTS AND AUTHORITIES CITED IN APPELLANTS' BRIEF.

It requires nothing more than a cursory reading of Dasa's brief to demonstrate the accuracy of the foregoing statement. We have listed below, in order of their appearance in appellants' brief, a number of the major arguments made and controlling authorities cited therein to which Dasa has in no way responded in its brief.

(1) Dasa has not responded to appellants' argument that this Court's recent decision in Schlick v. Penn Dixie Cement Corp., ____F.2d____ (2d Cir. 10/31/74), CCH Fed.Sec. L.Rep., Curr. Vol. ¶94,853, is a controlling precedent requiring reversal of the judgment below. In fact, Dasa's brief neither cites nor discusses that patently dispositive precedent.

(2) No response is made to appellants' argument that the D.C. Circuit's opinion in National Life Ins. Co. v. Silverman, 454, F.2d 899 (D.C. Cir. 1973), demonstrates the general importance and worthiness of review in their appeal from the pretrial order below as it involves the failure of the district court below to obey the mandate of FRCP 56(d). In fact, Dasa's brief neither cites the Silverman case nor discusses the implications of its reasoning and holding for purposes of this appeal. Surely this Court has some general obligation as an

appellate court to review on appropriate occasions the manner in which the district judges in this circuit do or do not administer the FRCP's in a manner consistent with their language and intent. And Dasa has in no way refuted the perfectly obvious proposition that this Court unquestionably has discretionary authority under Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541 (1949), and Gillespie v. U.S. Steel Corp., 379 U.S. 148, 152-154 (1964), to review the pretrial order involved in this appeal. We respectfully submit that Cohen and Gillespie demonstrate the existence of appropriate discretionary jurisdiction and that Silverman indicates the worthiness of the issues presented for review and determination by this Court.

(3) No response is made to appellants' argument that the opinion of dismissal below violated Rule 56 because it failed to resolve all material questions of fact and law in favor of Dasa and, instead, left questions of both kinds open and undecided. Enough said.

(4) No response is made to Point III of appellants' brief, i.e., that acceptance by this Court of Dasa's "mootness" argument would violate the legislative purpose of Section 14(a) and create a gigantic and pernicious gap or loophole in the law thereunder.

(5) No response is made to the point made at page 7 of appellants' brief that the decision of Judge Motley on May 8, 1972, which (a) refused to grant a preliminary injunction, (b) expressly authorized immediate completion of the transaction

at issue, and (c) thus mooted and aborted the Browning Committee's proposed counter solicitation of the debenture holders, was based upon assumptions of controlling fact which subsequently proved to be unfounded or untrue.

(6) No response is made to the point made at pages 8-16 of appellants' brief that Judge Owen's negative ruling on plaintiffs' class action motion was based upon numerous errors of fact and law.

(7) No response is made to the point made at page 15 of appellants' brief that (a) Dasa's determination of the proposed new conversion price of $21.00 was based upon the biased assumption that Dasa owed a duty to the stockholders but none to the bondholders in that connection and (b) the stockholder proxy materials failed to disclose either that fact or the related fact that it was likely to result in extensive litigation for the company. Indeed, Dasa clearly admits those facts in its brief and simply argues that, as a matter of law, no such duty to the bondholders existed. (See Point I above.)

(8) No response is made to appellants' citation (at page 48 of their brief) of District Judge McLaren's recent decision in Bailey v. Meister-Brau, Inc., _____F.Supp._____ (N.D. Ill., 1974), CCH Fed.Sec.L.Rep., Curr. Vol., ¶94,837, as a precedent relevant by analogy to the present case. That case is not cited in Dasa's brief.

CONCLUSION

For the reasons set forth above, each of the decisions below here appealed-from should be reversed and remanded for appropriate corrective action by the district court.

Dated: New York, N.Y.
March 20, 1975

Respectfully submitted,

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AFFIDAVIT OF SERVICE BY MAIL

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

Jack N. Weber, being duly sworn, deposes and says, that deponent is not a praty to the action, is over 18 years of age and resides at 231 Thompson St., NYC. That on the 21st day of March, 1975, deponent served the within Reply Brief of Appellants upon Jacobs, Persinger & Parker (attorneys for defendant Dasa Corp.) and Breed Abbott & Morgan (attorneys for defendant Arthur Andersen & Co.), at 70 Pine Street, N.Y.,N.Y. 10005 and One Chase Manhattan Plaza, N.Y.,N.Y. 10005, respectively, the addresses designated by said attorneys for that purpose by depositing a true copy of same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States post office department within the State of New York.

Jack N. Weber

Sworn to before me this
21st day of March, 1975

Bradley R. Brewer

BRADLEY R. BREWER
Notary Public, State of New York
No. 31-0411750
Qualified in New York County
Commission Expires March 30, 197